Empirical Study on Accounting and Tax Differences in the Case of an Economic Entity

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Abstract: Often enough, the definitions in tax regulations are not unique, and they can differ even within the fiscal legislation from one title to another. Thus the accounting regulations define the net turnover tax code, but at the same time it brings different definitions of turnover in terms of added value. The turnover for professionals in accounting is an indicator used to represent the value and the synthetic of the achieved sales by an economic unit during a certain period or a business segment. Also the fiscal elements come to generate a new identity of the taxable result, totally different from the accounting result. There are found clear value differences between accounting and tax perspective on the outcome in terms of operating profit and expenses. These differences at the level of operating costs continue to affect key indicators of the structure of the profit account and loss until determining the gross profit, which differs in the accounting vision compared to the gross profit in the fiscal vision.

Keywords: tax turnover; accounting turnover; gross profit in the accounting vision; gross profit in the taxing vision; taxation

1. The Tax and Accounting Differences at the Level of Terminology Regarding the Turnover

Professional accountants understand the concept of turnover as defined by the statutory accounting rules (Finance Minister's Orders 3055/2009), and often they overlook that tax regulations are calling on other specific definitions for certain items already defined in the specialized literature and in the accounting legislation. The accounting regulation defines the net turnover comprising “proceeds from the sale of products and providing services falling under the current activity of the entity, after deducting the commercial discounts and value added tax and other

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taxes directly related to business turnover" (Finance Minister's Orders 3055/2009, pt. 33, paragraph 1).

Meanwhile the Tax Code brings different definitions of turnover in terms of VAT:

1. The turnover as a price ceiling to the establishment of the special regime of exemption for small enterprises:

According to the Tax Code, the turnover comprises: the total value, excluding tax (VAT) of supplies of goods and services made by the taxable person during a calendar year, taxable or, where appropriate, they would be taxable if the operations were not carried out by a small company, representing the intra-community transactions of goods, providing intra-community services of other deliveries for which the place is considered to be abroad, transactions exempt from the VAT and those exempt without deductibility provided art. 141, paragraph (2), letters a), b), e) and f) if they are not ancillary to the main business, except the following:

a) supply of tangible or intangible fixed assets, as defined by the tax code;

b) intra-Community supplies of new means of transport, exempt under the tax code.

2. The turnover as a price ceiling for the establishment of the fiscal period includes taxable transactions and/or exempted from the VAT and/or non-taxable in Romania, but granting the right to be deductible.

For all the above two price ceilings, according to the Tax Code, the entities will be considered in the calculation of turnover including receipts or invoices for unearned advances and other bills issued before the date of delivery / provision.

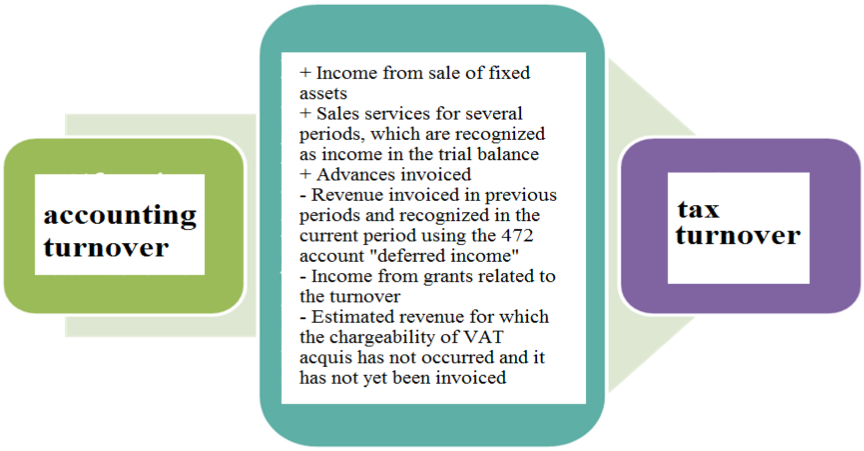

Figure 1. The transition from tax turnover to the accounting turnover

At the same time, the tax turnover includes some items that are not included in the accounting turnover such as the sales of assets, sales of services for several periods, which are recognized as deferred income in the trial balance, advances billed but, at the same time, it excludes certain items from the accounting turnover namely: the revenue invoiced in previous periods and recognized in the current period using the 472 account "deferred income", income from subsidies related to the turnover, estimated revenues for which the chargeability of VAT has not been held and has not been yet invoiced.

2. Accounting and Tax Perspective on Gross Operating Result

The influence of taxation on accounting often leads to distortion of the economic content of the presented indicators. A good example is the comparative analysis of presenting the key indicators of income and expenses in the Form 20 of financial statements and those presented in Statement 101 - Income Tax Statement, and more specifically, the content of operating expenses from the accounting point of view versus the content of expenses operating expenses from the taxing point of view. If in the case of profit and loss account, operating expenses are "uncovered" by fiscal influences, we find that the instructions for completing the form 101 "Statement regarding income tax", where it specifies at line 2 "operating expenses" to complete also the "expense with income tax."

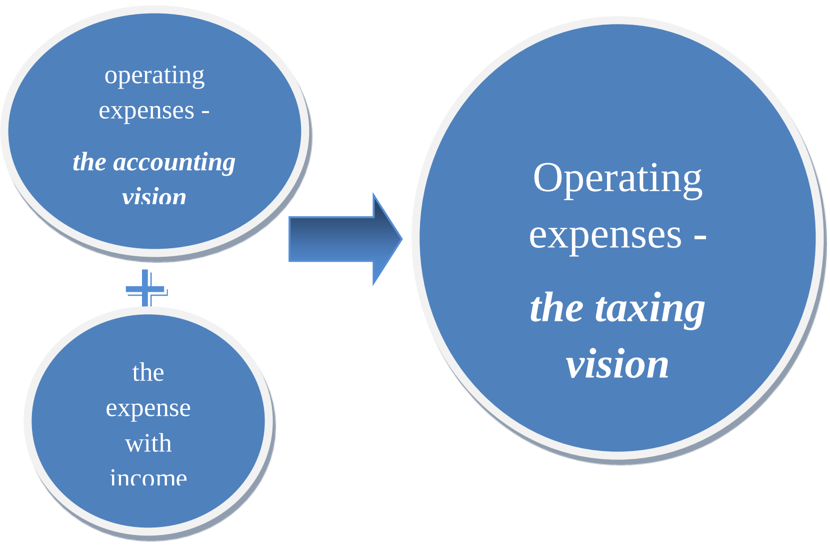

Figure 2. Operating expenses - accounting vision vs. tax vision
Source: Authors' processing

In the case of our company, we find clear value differences between the two visions in the following table showing the operating result, depending on the interpretation, the accounting or taxing.

Table 1. Profit and loss according to accounting and tax vision

Elements of the CPP according to the accounting vision	2007	2008	2009	2010	2011	2012	2013
Operating income	669.611	1.077.801	1.540.995	3.689.860	2.918.780	1.513.647	1.691.644
Operating expenses	486.826	673.901	1.061.600	1.598.350	2.139.524	1.728.611	1.528.727
Operational result sheet (RexC)	*182.785*	*403.900*	*479.395*	*2.091.511*	*779.256*	*-214.964*	*162.917*
Elements of the CPP as tax vision	2007	2008	2009	2010	2011	2012	2013
Operating income	669.611	1.077.801	1.540.995	3.689.860	2.918.780	1.513.647	1.691.644
Operating expenses (including income tax expense, according to the statement 101)	513.685	735.746	1.129.167	1.911.926	2.247.475	1.732.381	1.528.727
Tax Operational result (RexF)	*155.926*	*342.056*	*411.829*	*1.777.934*	*671.305*	*-218.734*	*162.917*

The differentiation between tax and accounting vision is evident in the considered period, which is more extensive in the period 2009 - 2011, following a decrease, and towards the end of the period, an equalization in terms of value of the two types of operating results.

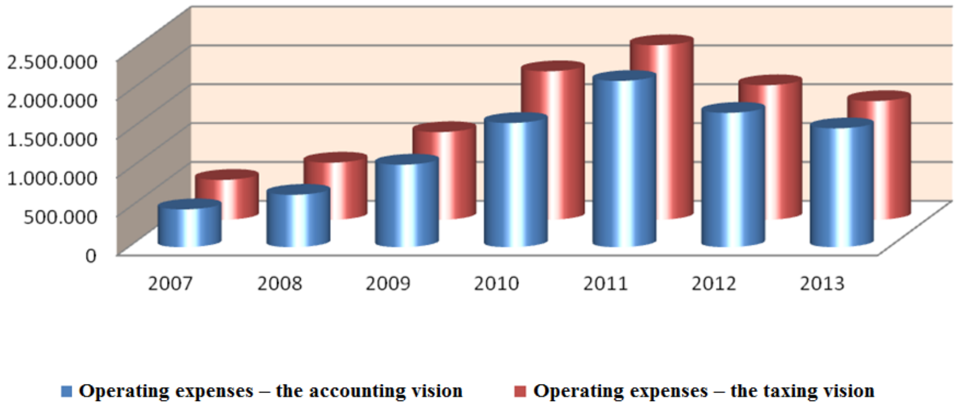

Figure 3. The Evolution of operating costs in the two visions

This differentiation is observed more clearly from the chart below, the cause and magnitude of different values of this indicator is given just by the income tax expense.

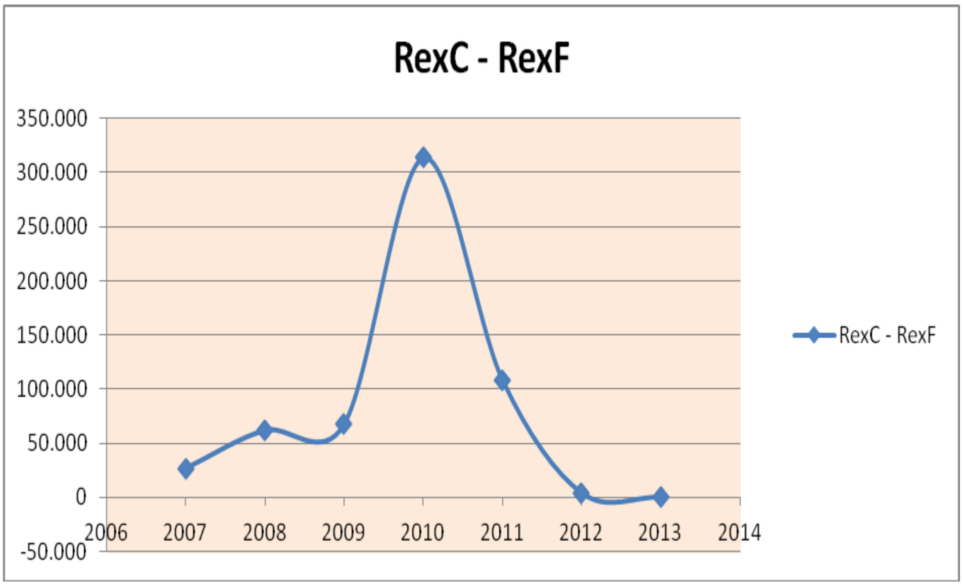

Figure 4. The Evolution of the difference between the tax and accounting operating income

It results that given the magnitude of the difference between the calculation of the operating result in fiscal and accounting vision, the result is kept downstream to determine gross income, both in the tax and accounting vision. The following figure has highlighted the developments in the period under review two visions.

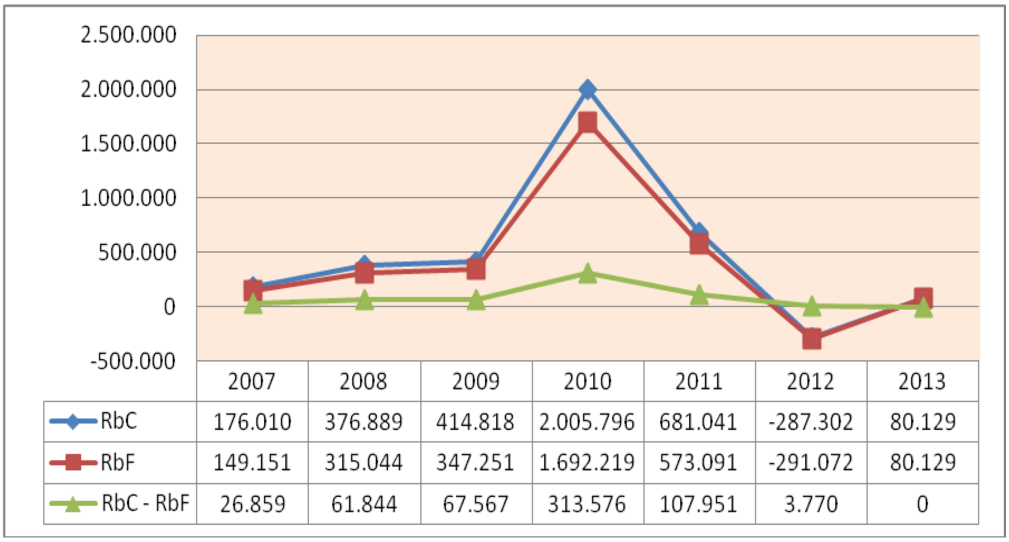

Figure 5. The evolution of gross accounting vs taxing operating outcome

From the above figure it results that the magnitude of the variation is given by the value of tax expenditures.

Table 2. The determination in the accounting and tax vision of gross operating outcome

No.	Elements of Profit and Loss Account		2007	2008	2009	2010	2011	2012	2013
1	Accounting vision	Operating income	669.611	1.077.801	1.540.995	3.689.860	2.918.780	1.513.647	1.691.644
2		Operating expenses	486.826	673.901	1.061.600	1.598.350	2.139.524	1.728.611	1.528.727
3		Operational result (rd.1 - rd.2)	*182.785*	*403.900*	*479.395*	*2.091.511*	*779.256*	*-214.964*	*162.917*
4		financial income	2.781	786	26.172	66.471	56.639	129.073	106.742
5		financial expenses	9.556	27.797	90.749	152.185	154.854	201.411	189.530
6		Financial result (Rd.4 - rd.5)	*-6.775*	*-27.011*	*-64.577*	*-85.715*	*-98.215*	*-72.338*	*-82.788*
7		extraordinary income	0	0	0	0	0	0	0
8		extraordinary	0	0	0	0	0	0	0

		expenses							
9		Extraordinary Result (rd.7-rd.8)	*0*	*0*	*0*	*0*	*0*	*0*	*0*
10		Gross (rd.3 + R d-6 + rd.9) (RBC)	*176.010*	*376.889*	*414.818*	*2.005.796*	*681.041*	*-287.302*	*80.129*
11	**Tax vision**	Operating income	669.611	1.077.801	1.540.995	3.689.860	2.918.780	1.513.647	1.691.644
12		Operating expenses	513.685	735.746	1.129.167	1.911.926	2.247.475	1.732.381	1.528.727
13		Operational result (rd.11 - rd.12)	*155.926*	*342.056*	*411.829*	*1.777.934*	*671.305*	*-218.734*	*162.917*
14		financial income	2.781	786	26.172	66.471	56.639	129.073	106.742
15		financial expenses	9.556	27.797	90.749	152.185	154.854	201.411	189.530
16		Financial result (rd.14 - rd.15)	*-6.775*	*-27.011*	*-64.577*	*-85.715*	*-98.215*	*-72.338*	*-82.788*
17		extraordinary income	0	0	0	0	0	0	0
18		extraordinary expenses	0	0	0	0	0	0	0
19		Extraordinary Result (rd.17-rd.18)	*0*	*0*	*0*	*0*	*0*	*0*	*0*
20		Gross (rd.13 + rd.16 + rd.19) (RBF)	*149.151*	*315.044*	*347.251*	*1.692.219*	*573.091*	*-291.072*	*80.129*
RbC - RbF			***26.859***	***61.844***	***67.567***	***313.576***	***107.951***	***3.770***	***0***

The above table presents the differences between the gross operating result in the accounting and tax vision, using the indicators of the analyzed company in the period 2007-2013.

3. The Accounting Result versus Tax Result

In the common language of professional accountants, the notion of *profit* is identified with the one of *outcome*, even if at the semantic level it has a speculative acceptation, while the outcome cannot be viewed only as a consequence of an action or accumulation of actions under the rule of causality. The concept of outcome is far more generous, not only in terms of the specifics of economic activities, involving investment followed by the outcome, but also because it accepts and it incorporates the alternative of profit, i.e. the loss.

A secular approach of terminologies with which the taxing and accounting are operating, would let to understand that the tax is calculated by applying a percentage to the positive gross result of the economic entity. But the practice is completely different.

The path from the accounting outcome based on the fiscal imposition is more complex, full of challenges arising from the differences that arise between the accounting policy of the company and state fiscal philosophy.

For the purposes of determining the taxable base, the Romanian Tax Code comes with a wide range of adjustments and influences that bring the individual components included in the income statement, plus a series of tax incentives, according to the state fiscal policy.

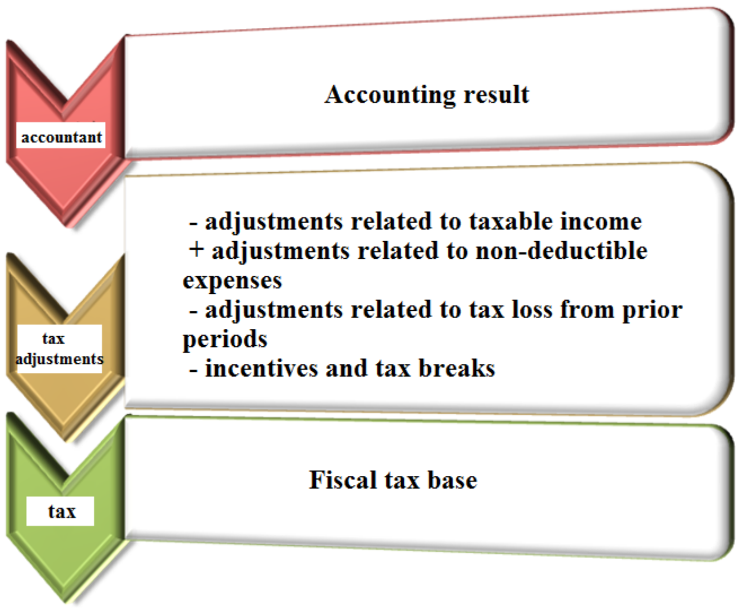

Figure 6. Switching from gross accounting profit at the fiscal tax base

In the case of the analyzed economic unit, switching from gross accounting profit to the taxable profit is shown in the table below:

Table 3. Determination of the basis of taxation

No		Indicators	2007	2008	2009	2010	2011	2012	2013
1	Determining the accounting outcome	Operating income	669.611	1.077.801	1.540.995	3.689.860	2.918.780	1.513.647	1.691.644
2		Operating expenses	486.826	673.901	1.061.600	1.598.350	2.139.524	1.728.611	1.528.727
3		Operational outcome (rd.1 - rd.2)	*182.785*	*403.900*	*479.395*	*2.091.511*	*779.256*	*-214.964*	*162.917*
4		financial income	2.781	786	26.172	66.471	56.639	129.073	106.742
5		financial expenses	9.556	27.797	90.749	152.185	154.854	201.411	189.530
6		Financial result (Rd.4 - rd.5)	*-6.775*	*-27.011*	*-64.577*	*-85.715*	*-98.215*	*-72.338*	*-82.788*
7		extraordinary income	0	0	0	0	0	0	0
8		extraordinary expenses	0	0	0	0	0	0	0
9		Extraordinary outcome (rd.7-rd.8)	*0*	*0*	*0*	*0*	*0*	*0*	*0*
10		Gross accounting outcome (rd.3 + Rd-6 + rd.9)	*176.010*	*376.889*	*414.818*	*2.005.796*	*681.041*	*-287.302*	*80.129*
11	Determining the taxing outcome	Adjustments related to taxable income	0	0	0	54.060	9.472	0	80.129
12		Adjustments related to non-deductible expenses	6.327	9.636	7.476	8.114	3.124	310.864	0
13		Adjustments related to prior period tax loss	14.468	0	0	0	0	0	0
14		Incentives and tax breaks	0	0	0	0	0	0	0
15		The basis of taxation (rd.10-rd.11 + rd.12-rd.13-rd.14)	*167.869*	*386.525*	*422.294*	*1.959.850*	*674.694*	*23.563*	*0*
16		Corporation tax (rd.15 x 16%)	*26.859*	*61.844*	*67.567*	*313.576*	*107.951*	*3.770*	*0*

It appears that in every year from the analyzed period, there were adjustments that led to the value delineation of the gross accounting outcome based on taxation. A graphical representation of this development clearly highlights these differences.

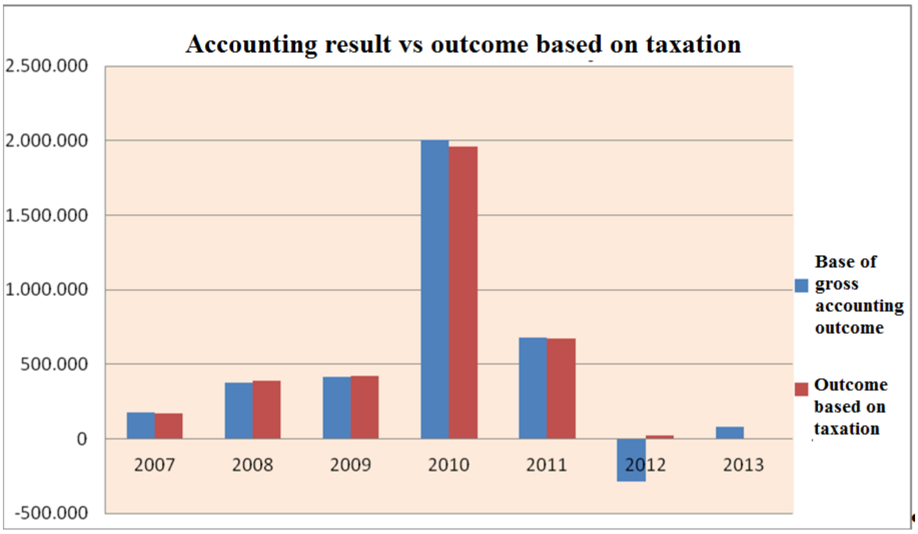

Figure 7. The evolution of the accounting result versus outcome based on taxation

Linked to the developments described in the previous figure, we note that during 2007 - 2013, the adjustments were relatively small, except 2012, when the unit recorded in the accounts a large volume of expenditure considered non-deductible for tax purposes.

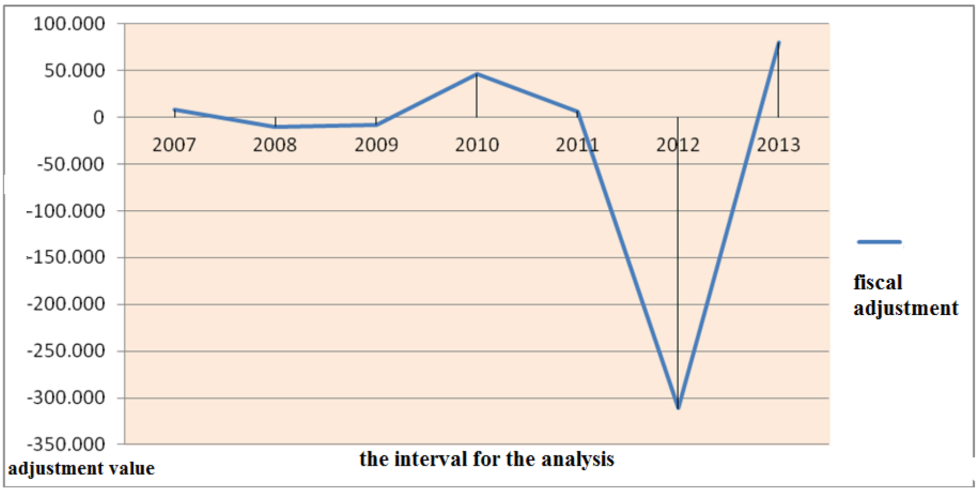

Figure 8. The Evolution of fiscal adjustments in 2007-2013

The magnitude of these influences on the gross accounting outcome is revealed by the evolution of the influence index of fiscal adjustments and the gross accounting outcome (calculated as their ratio).

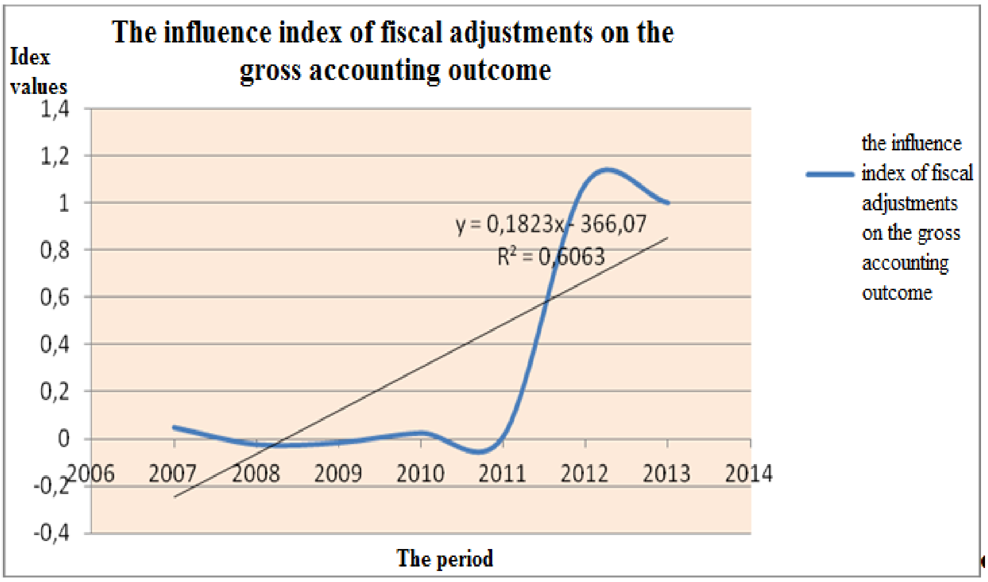

Figure 9. The evolution of the influence index of fiscal adjustments on the gross accounting outcome

We find that the intensity of this index increases towards the end of the analyzed time period, due to the leverage resulting from diminishing the gross accounting outcome compared with the average increase of fiscal adjustments in this period.

A comparative analysis of the influences of fiscal adjustments on gross operation outcome, i.e. on the operating income that confirms the same trend of development as in the case of influence index of fiscal adjustments on the gross accounting outcome, but of a lesser magnitude, as seen in the following figure:

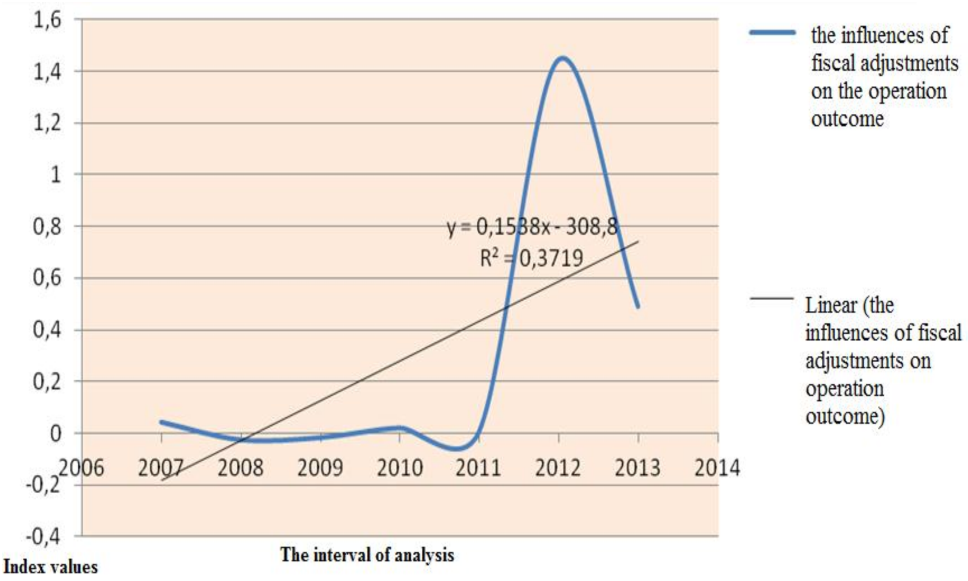

Figure 10. The Evolution of the influence index of fiscal adjustments on the operating outcome

Another interesting analysis is the comparison of fiscal adjustments influences on operating revenues and expenses, as defined in the accounting terms, given that their economic substance is affected by these adjustments.

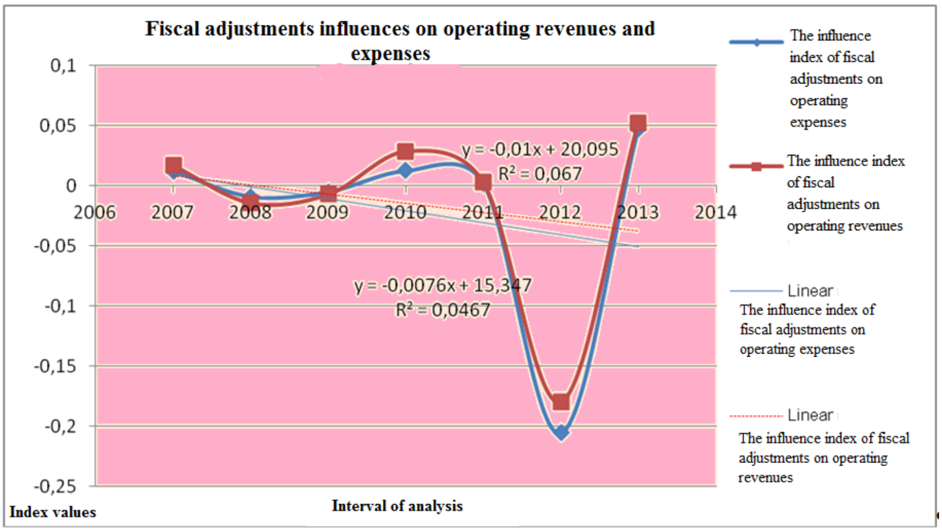

Figure 11. Fiscal adjustments on operating revenues and expenses

Graphically, we find that fiscal adjustments are as significant as the operating revenues and on operating expenses, with a slight superior tendency in terms of operating revenues.

4. Conclusions

As a conclusion to the matter described above, although complementary in terms of the origin or economic transaction, accounting and taxation operate with a set of indicators, in terms of semantics, similar but distinct in terms of scope and definition. The values that we derive from accounting reports often do not have the same valence and fiscal significance, having to make recourse to a complex set of adjustments in order to connect them.

We find that accounting and tax legislation define the turnover in their own way and in everyday activity and everyday language of professional accountants, the two definitions coexist, which can generate high risks of misunderstanding the turnover. The domain and context in which it makes use of this concept should be clearly delimited, in order to avoid the serious consequences that may arise at the application level; in the fiscal or accounting context any errors of interpretation can generate increases and penalties, if it is identified during a tax audit.

No matter how useful it would be in taxing terms an expenditure classification, in the sense of including the income tax with profit taxing in operating expenses of the company, such an approach could create confusion in the subsequent analysis of the position indicators and the performance of an economic unit.

We can say, in our view, that the concept of *account of results* is more appropriate for the *account of profit and loss*, given that both valences account cannot be, positive or negative.

The involvement of taxation in this semantic divergence has the gift of granting a high percentage to the concept of profit and loss account, in the light of the objective pursued by the tax: *profit tax*. This emphasis is manifested only due to the tax titles, although the real fiscal objective is to determine the basis of taxation, and consequently the profit tax.

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